COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Pricing, based upon Total Element Long-Run Incremental Costs, for Unbundled Network Elements and Combinations of Unbundled Network Elements, and the Appropriate Avoided Cost Discount for Verizon New England, Inc. d/b/a Verizon Massachusetts' Resale Services in the Commonwealth of Massachusetts.	)	D.T.E. 01-20

MCI'S OPPOSITION TO VERIZON MASSACHUSETTS' MOTION TO REOPEN THE RECORD

WorldCom, Inc. ("MCI") submits these comments in opposition to Verizon Massachusetts' ("Verizon") Motion to Reopen the Record of this proceeding. Verizon's motion is patently flawed in many respects and should be denied. Verizon's claim that the Department's approval of new UNE rates constitutes an unlawful taking is clearly nothing more than the latest attempt by Verizon to continue its opposition to cost based pricing of unbundled network elements that are needed by Verizon's competitors to offer local service in Massachusetts in competition with Verizon. MCI calls on the Department to reject Verizon's motion in all respects.

MCI will demonstrate that Verizon's request is actually an untimely motion for reconsideration of the July 11, 2002 Order in this proceeding and should be rejected as such. Moreover, we will show that the Department lacks jurisdiction to entertain Verizon's taking claim. Further, Verizon's claims are premature, given its failure to take other measures to address its claimed financial distress. Finally, Verizon's Motion and supporting evidence fail to make a *prima facie* showing of a taking.

INTRODUCTION

Earlier this month, over a year after the initial decision by the Department in this docket and months after the Department's disposition of several motions for reconsideration, Verizon now seeks the opportunity to reopen the evidentiary record to support its claim that the new UNE rates approved by the Department fail to provide Verizon with just compensation, as required by the Federal and Massachusetts Constitutions. Verizon alleges that the new UNE rates approved by the DTE on July 16, 2003 do not allow Verizon to "recover its prudent historic investments and the associated real-world operating costs of providing UNEs to CLECs." Verizon Mot. at 1-2. As a result, Verizon alleges that, under the new rates, it will not be able to earn a "constitutionally sufficient rate of return," and that the new rates substantially compromise Verizon's financial integrity. Verizon Mot. at 2.

The evidence presented by Verizon consists of two studies that purport to show that Verizon's monthly cost of providing a loop is over $25, and its monthly cost of providing UNE-P is over $40. Verizon Mot. at 5; See Testimony of Harold E. West, III and Marsh S. Prosini (herein "West, *et al*."), at 3, 10-11, 20. Verizon alleges that the DTE-approved rates, i.e. a monthly state wide average loop rate of $13.93 and an average UNE-P rate of $18.69, cause a significant revenue shortfall, alleged to be approximately $45 million for the period August 2002 to June 2003. West, *et al.* at 3. Finally, Verizon claims that if historical growth trends continue, the annual shortfall could reach more than $113 million by the year 2005. Verizon Mot. at 5.

For the reasons stated below, Verizon's claims are wholly without merit and should be rejected.

ARGUMENT

I. VERIZON's MOTION IS AN UNTIMELY REQUEST FOR RECONSIDERATION OF THE JULY 11, 2002 ORDER.

When the Department issued its initial rate decision on July 11, 2002, Verizon was well aware of the rates that would result from the Department's determinations on the various costing issues litigated by the parties and decided by the Department. Verizon undoubtedly did what consultants for MCI did: they took the Verizon cost models, made the changes to the inputs adopted by the Department and generated rates for the numerous UNEs provided by Verizon. Although some issues may have required clarification, Verizon, like MCI and the other parties to the docket, had a sufficiently precise quantification of the resulting rates to allow it to frame its petition for reconsideration. Indeed, Verizon focused its reconsideration petition on the UNE rates that would have changed the most under the initial decision, namely Verizon's rates for unbundled local switching.

Nevertheless, Verizon's motion for reconsideration and clarification of the July 11, 2002 decision did not raise the takings issue. In its reconsideration motion, Verizon argued that the July 11, 2002 decision "will have the effect of driving rates significantly below Verizon MA's forward-looking TELRIC costs" and that rates that are "too low will discourage facilities-based investment and devalue the investments carriers have already made in telephone facilities in this state." Verizon Reconsideration Mot. at 2. Verizon could have but chose not to make the additional argument that the rates resulting

from the July 11, 2002 order are so low that they constitute an unconstitutional taking of property.

The proper time for Verizon to have made its takings argument was in its motion for reconsideration. Under the Department's rules and well established DTE precedent, a motion for reconsideration is the proper vehicle to raise errors of law committed by the Department or to present "previously unknown or undisclosed facts that would have a significant impact upon the decision already rendered…" *Boston Edison Company*, D.P.U. 90-270-A, at 2-3 (1991); *Western Massachusetts Electric Company*, D.P.U. 85-270-C, at 12-13 (1987). Clearly, Verizon could not have made its takings argument in the case prior to the Department's initial determination of the costing issues. But after that decision, Verizon had ample opportunity to assess the impact of the decision on its UNE rates and its overall Massachusetts revenues and to make any and all legal arguments about the initial decision in its motion for reconsideration. Having failed to do that, Verizon cannot now be heard to say that there is "new evidence" that the Department did not have (or could not have had) at the time it ruled on the several motions for reconsideration.

Verizon alleges that it could not have sought this relief earlier because "as a practical matter, until final rates were adopted, Verizon MA could not calculate the shortfall with specificity and could not present that calculation to the Department for its consideration." Verizon Mot. at 3. This argument is not credible. Verizon had the ability to determine in July 2002 what the impact of the initial decision would be on its UNE rates, just as did MCI as a purchaser of those UNEs. Verizon unreasonably expects the

Department to believe that Verizon only now has figured out what the impact of the new rates will be on its UNE revenues and its total Massachusetts intrastate revenues.

Likewise, for the same reason, a motion to reopen the record is not appropriate. Verizon has not shown sufficient "good cause" to justify a decision to reopen the evidentiary record under 220 CMR §1.11(8). The impact of the Department's decision on Verizon's UNE rates was an issue that Verizon could have raised in its motion for reconsideration. Having failed to properly preserve the issue, Verizon cannot now attempt to correct its mistake by alleging the existence of "previously unknown" information in order to reopen the proceeding.

II. THE DEPARTMENT LACKS JURISDICTION OVER VERIZON'S TAKINGS CHALLENGE.

The takings claim that Verizon seeks to mount before this Department is extraordinary. Verizon suggests in passing that the Department misapplied TELRIC and that, as a result, the rates adopted by the Department are unlawful. If that were the extent of Verizon's argument, it would be nothing more than yet another petition for reconsideration and should be rejected out of hand. The thrust of Verizon's current motion, however, is that even if the UNE rates adopted by the Department are *properly TELRIC-based*, they are so low that they are confiscatory and should be raised *above* the rates mandated by the FCC's binding TELRIC methodology. The Department unquestionably lacks jurisdiction to grant Verizon that relief.

A. Congress Delegated to the Department Jurisdiction to Determine Whether UNE Rates Are Consistent Only With the Act and the FCC's Binding Regulations.

Where a state undertakes to set UNE rates pursuant to the authority delegated under the 1996 Act, the FCC's pricing regulations require the state to set UNE rates consistent with Sections 251 and 252 of the Act and the FCC's TELRIC pricing methodology. *See* 47 U.S.C. §§ 252(e)(2)(B), 252(c)(1); 47 C.F.R. §§ 51.503, 51.505. Unless an FCC regulation has been stayed or vacated by an appellate court with appropriate jurisdiction, courts and state commissions must "apply it as it is written." *U S West Communications, Inc. v. Hamilton*, 224 F.3d 1049, 1055 (9th Cir. 2000); *GTE South, Inc. v. Morrison*, 199 F.3d 733, 742-43 (4th Cir. 1999) (Hobbs Act requires state commissions to apply the FCC's regulations as written).

As the Department is well aware, the FCC's TELRIC regulations have been upheld by the United States Supreme Court, *see Verizon Communications Inc. v. FCC*, 535 U.S. 467 (2002). Accordingly, the FCC's TELRIC regulations are binding on all state commissions and must be applied *as written*. *See generally Pacific Bell v. Pac-West Telecom, Inc.*, 325 F.3d 1114, 1126 n.10 (9th Cir. 2003) (under the Act, "state commissions are 'deputized' federal regulators . . . and are confined to the role that the Act delineates") (citing cases); *MCI Telecomm. Corp. v. Bell Atlantic-Pa.*, 271 F.3d 491, 516 (3d Cir. 2001) (state commissions have no authority to deviate from FCC regulations and any state commission determination that is inconsistent with FCC regulations must be struck down). It follows, therefore, that by virtue of the Supremacy Clause of the United States Constitution, the FCC's binding regulations preempt all inconsistent state

policies and laws, including state constitutional laws.[1] *See Fidelity Fed. Sav. & Loan Assocs. v. de la Cuesta*, 458 U.S. 141, 153-54 (1982) ("Federal regulations have no less pre-emptive force than federal statutes."); *Freeman v. Burlington Broadcasters, Inc.*, 204 F.3d 311, 321 (2d Cir. 2000) (FCC regulations "have the same preemptive force as federal statutes") (citing *Fidelity Fed. Sav. & Loan Assocs.*, 458 U.S. at 153-54).

In this proceeding, the Department already has determined that the UNE rates it adopted are consistent with TELRIC and that the higher rates proposed by Verizon could not be squared with dictates of the Act and the FCC binding regulations. *See* D.T.E. 1-20 Order, July 11, 2002. That is where the Department's delegated authority comes to an end. As the Act makes clear, the Department has jurisdiction to reject UNE rates *only* if they are inconsistent with Sections 251 and 252 of the Act and the FCC's regulations. 47 U.S.C. §§ 252(e)(2)(B), 252(c)(1). Congress has *not* delegated to the various state commissions the jurisdiction to go further and determine whether lawful TELRIC rates may effect a taking as applied to a particular incumbent LEC. That, as shown below, is exclusively the domain of the FCC and the federal courts. Having found that the UNE rates it adopted are consistent with TELRIC, raising those rates above TELRIC, for whatever reason, would violate the Act and the FCC's regulations and would constitute reversible error.[2] *See, e.g., Pacific Bell*, 325 F.3d at 1126 n.10 (under the Act, "state

[1] Accordingly, Verizon's contentions that the takings clauses of the Massachusetts Constitution require that UNE rates be raised above the lawful TELRIC rates adopted by the Department are clearly wrong. *See* 47 U.S.C. § 261(c) (preserving state authority only in so far as its exercise is not inconsistent with the Act or the FCC's regulations); 47 U.S.C. § 253(a).

[2] Verizon's reliance on *Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168 (D.C. Cir. 1987), for the proposition that the Department "*must* consider" its takings allegations, Verizon Mot. at 4 (emphasis in original), is sorely misplaced. There, the FERC — a federal regulator —was directly charged with imposing rates that were "just and reasonable" and not confiscatory. *Id.* at 1175. Thus, in that context, the D.C. Circuit held that the FERC was required to take evidence on the appellant's takings claims. Here, by contrast, the Department is charged solely with adopting UNE rates that are consistent with the FCC's binding TELRIC regulations. 47 U.S.C. §§ 252(e)(2)(B), 252(c)(1). Any deviation from that statutory command would be unlawful.

commissions are 'deputized' federal regulators . . . and are confined to the role that the Act delineates").

B. Verizon's Taking Claim May be Brought Only in the FCC or the Federal District Courts.

If Verizon could demonstrate a taking (which it cannot do for the reasons discussed below), venue properly would lie in the FCC. As the United States Supreme Court has made clear, an incumbent carrier may petition *the FCC* for relief from the FCC's pricing methodology if it can "provide specific information to show that the pricing methodology, as applied to them, will result in confiscatory rates." *Verizon Communications Inc.*, 535 U.S. at 528 n.39 (quoting *Local Competition First Report and Order*, 11 F.C.C.R. 15499 ¶ 739 (1996); *see also* 47 C.F.R. § 1.3 (permitting any party to petition the FCC for a waiver from the Commission's rules). As the federal agency authorized to adopt binding national rules for the pricing of UNEs, *see AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 377-386 (1999), the FCC may, upon a showing that application of the TELRIC rules will result in confiscatory rates, grant an incumbent LEC relief from its TELRIC pricing rules. *Local Competition First Report and Order*, 11 F.C.C.R. 15499 ¶ 739 (1996). But, unless and until such relief is granted by the FCC, state commissions must apply the FCC's binding TELRIC methodology "as it is written." *U S West Communications, Inc.*, 224 F.3d at 1055; *GTE South, Inc.*, 199 F.3d at 742-43 (Hobbs Act requires state commissions to apply the FCC's regulations as written). If the FCC were to deny relief, then the incumbent presumably could file an action in the United States Court of Federal Claims under the Tucker Act, 28 U.S.C. § 1491(a)(1), seeking monetary compensation from the federal government on account of the allegedly unconstitutional pricing methodology adopted by the *federal* FCC.

Alternatively (and if Verizon first exhausted its state administrative remedies, *see infra*), a proper takings claim could be brought in the appropriate federal district court pursuant to 28 U.S.C. § 1331 or the judicial review provisions of 47 U.S.C. § 252(e)(6). *See U S West Communications v. MFS Intelenet, Inc.*, 193 F.3d 1112, 1126 (9th Cir. 1999); *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 818 (8th Cir. 1997), *aff'd in part on other grounds and rev'd in part on other grounds, AT&T Corp.*, 525 U.S. 366 (1999); *U S West Communications v. Minnesota Pub. Utils. Comm'n*, 55 F. Supp.2d 968, 988 (D. Minn. 1999).[3] Under no circumstances, however, is the Department authorized to hear Verizon's taking claim.

III. VERIZON'S TAKINGS CLAIM IS NOT RIPE FOR REVIEW IN ANY FORUM.

Regardless of the availability of other fora in which Verizon could mount a takings challenge, Verizon's claims in this case would be fatally premature in any forum. It is hornbook law that a takings claim is not ripe for review until the plaintiff has exhausted its state administrative remedies for seeking compensation.

As the United States Supreme Court has explained,

> The Fifth Amendment does not proscribe the taking of property; it proscribes taking without just compensation. Nor does the Fifth Amendment require that just compensation be paid in advance of, or contemporaneously with, the taking; all that is required is that a reasonable, certain and adequate provision for obtaining compensation exist at the time of the taking. If the government has provided an adequate process for obtaining compensation, and if resort to that process yield[s] just compensation, then the property owner has no claim against the Government for a taking. Thus, we have held that taking claims

[3] Indeed, Verizon affiliates, and other incumbent carriers, are currently pursuing takings challenges to UNE rates in a number of federal district courts throughout the country, including the United States District Court for the District of New Jersey and the United States District Court for the Northern District of California.

> against the Federal Government are premature until the property owner has availed itself of the process provided by the Tucker Act, 28 U.S.C. § 1491. Similarly, if a State provides an adequate procedure for seeking just compensation, the property owner cannot claim a violation of the Just Compensation Clause until it has used the procedure and been denied just compensation.

Williamson County Regional Planning Comm'n v. Hamilton Bank of Johnson City, 473 U.S. 172, 194-95 (1985) (internal quotations and citations omitted). The Court then succinctly summarized its holding: "because the Fifth Amendment proscribes takings *without just compensation*, no constitutional violation occurs until just compensation has been denied. The nature of the constitutional right therefore requires that a property owner utilize procedures for obtaining compensation before bringing a [takings] action." *Id.* at 195 n.13 (emphasis in original). *See also, e.g., Suitum v. Tahoe Regional Planning Agency*, 520 U.S. 725, 735 (1997) ("if a State provides an adequate procedure for seeking just compensation, the property owner cannot claim a violation of the Just Compensation Clause until it has used the procedure and been denied just compensation") (quoting *Williamson*, 473 U.S. at 195). Accordingly, in *Williamson*, the Court dismissed the plaintiff's claim because state procedures permitted the plaintiff to seek just compensation for the alleged taking, but the plaintiff had not yet done so. *Id.* at 196.

Here, as demonstrated above, the Department lacks jurisdiction under the 1996 Act to raise UNE rates in order to compensate Verizon for any alleged taking. There remain, however, a host of available administrative remedies of which Verizon can and must avail itself before alleging a taking without just compensation. Assuming for the sake of argument that Verizon's claimed UNE costs are as stated in its new studies, and thus produce the alleged revenue shortfalls, Verizon has failed to show that the Department has denied Verizon the ability to recover its prudent historical investment

and associated operating costs for its Massachusetts intrastate operations. Verizon has not petitioned the Department in DTE 01-31 to seek modifications of the recently approved Verizon Massachusetts Alternative Regulation Plan ("Verizon Plan") (D.T.E. 01-31—Phase II, April 11, 2003) to allow it maximum retail pricing flexibility to allow Verizon to attempt to recover the alleged revenue shortfalls resulting from the Department's decisions in this docket. *See* Verizon Plan, Section Q. Moreover, Verizon retains the option to ask the Department to completely scrap the Verizon Plan and request a general increase in rates, i.e. a traditional rate case. Filing a general rate case was the traditional step employed by the Bell companies when its earnings were allegedly too low. It has chosen not to do that either.

Of course, it was Verizon that sought to eliminate rate of return regulation in 1994, when it proposed the predecessor to the current Verizon Plan, arguing with success that changed industry conditions required regulators to sever the link between rates and costs, thereby allowing the company the right, subject to certain price caps and price floors, to price its services according to market conditions and to keep all its profits, with the full knowledge that the *quid pro quo* for that new form of regulation was to accept the risk that it could lose money as well, depending on economic conditions and the extent of competition. Nevertheless, in an attempt to "have its cake and eat it too," Verizon succeeded in gaining the right to increase capped rates in the event of exogenous events that might negatively impact Verizon's ability to realize greater profits. This same protection exists in the current Verizon Plan. Verizon Plan, Section N. Verizon has not sought the protection of those provisions either. Finally, Verizon offers no evidence that is has proposed, within the structure of the current Verizon Plan, to increase rates for

other services, up to the maximum allowed by the Verizon Plan and/or market forces in order to address its alleged financial distress.

Verizon's failure to take available regulatory paths to increase rates to increase its revenues and earnings demonstrates that financial distress is not really the issue here. Verizon's agenda here is to increase UNE rates to a point where its new competitors will not be able to compete. If Verizon were truly at a point where its financial integrity was being substantially compromised, it would have taken other steps to address the alleged revenue deficiencies. That is has failed to do so speaks volumes. It also renders Verizon's alleged taking claim premature.[4]

IV. VERIZON HAS FAILED TO MAKE A *PRIMA FACIE* SHOWING OF AN UNCONSTITUONAL TAKING OF ITS PROPERTY

A. UNE Rates That Allegedly Are Below Verizon's Historical Investment Do Not Establish a Taking.

The sum total of Verizon's "new" evidence that a taking has occurred is its allegation that the UNE rates adopted by the Department will not allow it to recoup its "historical investment required to provide UNEs to CLECs." Verizon Mot. at 4; *see also id.* at 5; *id.* at 6 (alleging that "[r]ates that fail to compensate the incumbent for its unrecovered prudent historical investment and actual out-of-pocket operating expenses"

[4] Verizon's contention that it is entitled to compensation now — "at the time of the taking" and cannot be forced to await appellate review or "some later action," Verizon Mot. at 4, is patently false. The Supreme Court has held unequivocally that the Fifth Amendment does not require "that just compensation be paid in advance of, *or contemporaneously with, the taking*; all that is required is that a reasonable, certain and adequate *provision for obtaining compensation* exist at the time of the taking." *Williamson County Regional Planning Comm'n*, 473 U.S. at 194-95 (emphasis added). The very case cited by *Verizon, see* Verizon Mot. at 4, n.9, makes the same point. *Preseault v. ICC*, 494 U.S. 1, 11 ("the Fifth Amendment does not require that just compensation be paid in advance of or even contemporaneously with the taking"). As long as procedures for obtaining compensation are available at the time of the taking, then "the property owner has no claim . . . ." *Id.* Here, as we have shown, adequate procedures are available for Verizon to seek compensation through a new retail rate making proceeding. That is has failed to avail itself of such proceedings is fatal to its takings claim.

are a taking); *id.* ("the Department's rates do not come close to covering Verizon MA's historical investment"). Such evidence, even if true — and it is not, does not begin to approach the requisite showing to prove a taking.

As an initial matter, Verizon's own figures show that, for 2002, the Department's TELRIC-based UNE rates will reduce its earnings by $20 million. West, *et al.* at 22.[5] Thus, compared to Verizon's claimed average net investment of $3.36 billion, *id.*, the Department's rate order would, even by Verizon's numbers, result in a loss of only 0.58% off of Verizon's average net investment, or total rate base.[6] Under similar circumstances, the Supreme Court has summarily rejected claims of losses *four and five times greater* than what Verizon alleges here as being "well within the bounds" of constitutional ratemaking. *See, e.g.*, *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 311-12 (1989).

More importantly, the Supreme Court has repeatedly stressed that loss of historical investment is irrelevant to a proper takings analysis generally and is particularly inappropriate in the context of UNE rates set pursuant to the 1996 Act. As the Court explained, the 1996 Act represents an "explicit disavowal" of traditional rate-of-return ratemaking in which the regulated incumbent was guaranteed recovery of its prudently invested historical costs. *Verizon Communications Inc.*, 535 U.S. at 489. Instead, Congress and the FCC together expressly forbade *any* reliance on an incumbent's actual historic investment, *see id.* at 511-12, and created a new regime in which UNE rates would be based on the forward-looking costs — not of the incumbent itself — but of a

[5] Specifically, they allege that, under the Department's rate order, Verzion MA's net return for 2002 would drop from $130 million to either $110 million or $109 million. *See* West, *et al.* at 22.

[6] Verizon's suggestion that its losses would be even greater if future demand for UNEs increases is rank speculation. And its suggestion that its *entire network* might one day be leased out as UNEs is not only

hypothetical network using the most efficient technology available and the lowest cost network design. *See id.* at 495-96, 501; 47 C.F.R. §§ 51.505(b)(1); 51.505(d)(1).

Significantly, both the Supreme Court and the FCC have squarely rejected the notion that TELRIC could constitute a taking because it failed to take account of the incumbent's historical investment. *See Verizon Communications Inc.*, 535 U.S. at 528 (citing *Local Competition First Report and Order* ¶ 706). Rather, to show a regulatory taking in the context of UNE rates, an incumbent must prove that the "total effect" of the UNE rates does not allow it "to operate successfully, to maintain its financial integrity, to attract capital, and to compensate investors for the risks assumed." *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944); *see also Verizon Communications Inc. v. FCC*, 122 S. Ct. 1646, 1679 (2002) (to prove that TELRIC-based UNE rates effect a taking, "the incumbent carrier [here Verizon] must show that the TELRIC rate adopted by the state commission is 'threatening [the] incumbent's 'financial integrity'"") (quoting *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307, 312 (1989)).

Thus, at a minimum, to state an allegation that an unconstitutional taking has occurred, Verizon would have to allege that the Department's rates, coupled with the extent of element leasing by competitors and the offsetting impact of other revenue sources have, in fact, threatened Verizon's financial integrity or its ability to attract capital. That is an incredibly high burden — "even the most egregiously confiscatory rate structure would have difficulty meeting" the "total effects" standard. Lawrence H. Tribe, *American Constitutional Law* § 9-3, at 593 n.3 (2d ed. 1988). Unsurprisingly, Verizon's "new" evidence does not begin to approach the necessary threshold.

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speculative, but is patently ludicrous. Not even the most optimistic CLECs would ever predict a time in which Verizon serves *no* local customers.

Although Verizon baldly asserts that "the Department's rates would threaten Verizon MA's financial integrity," *see* Verizon Mot. at 5, it offers no evidence — "new" or otherwise — to support that claim. Verizon's most recent Form 10-K filed with the Securities and Exchange Commission (under the name "Verizon New England Inc.," through which Verizon MA reports), touted a *net income* in 2002 of $233.2 million. That the loss of approximately $20 million (even if true) would threaten the company's viability in the face of $233.2 million in net income is absurd.

Indeed, the only numbers Verizon offers in support of its takings claim is that, under the Department's rate order, its return on average net investment would be approximately 3.29% for 2002. *See* Verizon Mot. at 5-7; West, e*t al.* at 22. But this says nothing at all about Verizon's financial integrity. First, Verizon's own data reveals that its return on average net investment for 2002 *before* the Department's rate order was only 3.87%. West, e*t al.* at 22.[7] Verizon makes no attempt at demonstrating how a 0.58% diminution in its return on average net investment would somehow threaten its financial integrity, or what return on average net investment it needs to maintain that integrity. Clearly, Verizon's return on average net investment in Massachusetts (only 3.87% *before* the Department's rate order) is affected far more by factors other than the new UNE rates, including but not limited to, its form of regulation, economic conditions, the reduction in first and second access lines due to competition from wireless and cable modem services, and the impact of wireless competition on toll revenues.

Moreover, Verizon's exclusive reliance on this nominal diminution in return is misleading. As the Supreme Court's takings jurisprudence and the FCC have made clear,

[7] The 3.87% figure is arrived at by dividing $130 million (Verizon's net return in 2002) by $3.36 billion (Verizon's average net investment for 2002). *See* West, *et al.*, at 22.

the "total effect" of any purported taking must be measured against all of the various ways in which Verizon generates revenue from its network. In Verizon's case, this would include its many opportunities to reap above-cost returns, such as through retail rates and other regulated intrastate services. *See Duquesene Light Co.*, 488 U.S. at 312 (measuring alleged loss against utility's total rate base, not just its investment in the specific plant allegedly taken by regulatory fiat); *Local Competition First Report and Order* ¶ 739 (any allegation that TELRIC rates are confiscatory would have to be measured against possibility that incumbent may recover some of its embedded costs through, for example, access charges); *Triennial Review Order* ¶ 167 (emphasizing that an incumbent's purported losses "should not be a matter for regulatory concern unless an incumbent LEC's *overall earnings for telecommunications services* fall below confiscatory levels") (emphasis added).[8] Yet, Verizon has not suggested that it intends to make any showing — or that it has any "new" evidence — to meet such an exacting standard.

Nor could it. Indeed, prior to the rate re-balancing ordered by the Department in D.P.U. 89-300, residential dial tone service was priced well below cost, with high rates for toll and switched access services making up the shortfall. Investors will look at the company's total revenues, not just UNE revenues, to determine the financial integrity of Verizon's operations. For example, if the alleged UNE losses resulted in reducing Verizon's intrastate revenues such that its intrastate return dropped from 20% to 18%,

[8] Verizon's passing reference to *Brooks-Scanlon* and its progeny, *see* Verizon Mot. at 7-8, n.19, is not to the contrary. There, where a state railroad commission allegedly took a lumber company's railroad without just compensation, the Court looked to all revenues generated by the railroad business, but not to the wholly separable revenues generated by the company's lumber business that were unaffected by its rail operations. *See Brook-Scanlon Co. v. R.R. Comm'n of Louisiana*, 251 U.S. 396, 399 (1920). Here, in the regulated utility context, the Supreme Court and the FCC have made it abundantly clear that Verizon's

Verizon could not credibly argue that it has been denied the opportunity to recover its historic investment plus its actual operating costs because of a significant reduction in Verizon's UNE rates. The Department, like the Supreme Court, the FCC and any rational investor, will look at Verizon's bottom line, not at prognostications of returns on individual UNEs and services.

B. Verizon's Evidence is Wrong on its Face.

Even if the alleged gap between Verizon's claimed UNE costs and new UNE rates were relevant to the takings question, it can readily be shown that Verizon's own evidence shows that its claimed UNE costs are vastly overstated. First, Verizon shows that its total operating revenues for 2002 were $2.487 billion. (*See* West, *et al.*, Attach. A at 3, line 1.) Verizon further shows that its total revenues subject to the avoided cost discount are $1.904 billion. (*Id.* at 11, line 39.) Thus, using the conservative assumption that Verizon's costs and revenues are the same, if Verizon were to sell all of its switched lines (4,239,936) (*Id.* at 13, line 10) as UNE-P lines, its total annual revenues would be $1.926B: ($2.487B-[29.47% (the avoided cost discount)*1.904B]=$1.926B. Verizon's total claimed annual UNE costs are $2.089B (4,239,936*41.06*12). Thus, Verizon would have the Department believe that its claimed UNE costs, using the new studies, are $2.089 billion, while its own financial data show, again assuming costs equal revenues, that its costs as a wholesale-only company would be only $1.9 billion. This discrepancy is significantly greater than the losses from lower UNE rates alleged by Verizon. Verizon's new studies are simply not credible.

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entire rate base and "overall earnings from all telecommunications services" must be considered. *See Triennial Review Order* ¶ 167.

There would be no point served in litigating the accuracy of these new cost presentations when Verizon has failed to take actions to improve its own financial condition, as described above, and, more importantly, as shown above, when its current financial condition is not materially affected by the new UNE rates set by the Department.

CONCLUSION

For all the reasons stated above, Verizon's Motion to Reopen the Record should be denied.

Dated: September 3, 2003

Respectfully submitted,

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